

**LODI CITY COUNCIL  
SPECIAL CITY COUNCIL MEETING  
CARNEGIE FORUM, 305 WEST PINE STREET  
TUESDAY, OCTOBER 22, 2002**

**A. CALL TO ORDER / ROLL CALL**

The Special City Council meeting of October 22, 2002 was called to order by Mayor Pennino at 7:05 a.m.

Present: Council Members – Hitchcock (arrived at 7:06 a.m.), Howard, Land, Nakanishi, and Mayor Pennino

Absent: Council Members – None

Also Present: City Manager Flynn, City Attorney Hays, and City Clerk Blackston

**B. REGULAR CALENDAR**

- B-1 “Adopt resolution authorizing the approval of certain documents related to the financing of the amended power sales agreement between Calpine Corporation and the City of Lodi”

City Manager Flynn reported that in the last few months interest rates have gone down significantly. Refinancing the existing contract with Calpine will bring the monthly payments down from \$1,200,000 to \$525,000.

Electric Utility Director Vallow explained that the proposed transaction came about as a result of the Utility's perceived future risk with having the contract and Calpine needing cash.

Mayor Pro Tempore Hitchcock mentioned that she had read an article from the Federal Energy Regulatory Commission (FERC) regarding possible negotiation of a settlement to reduce the price some cities had paid for long-term contracts. Given this, she asked Mr. Vallow if the proposed action may be premature.

Mr. Vallow replied that he was aware of the situation and had already given it consideration.

Council Member Land commented that he recently attended a Northern California Power Agency (NCPA) meeting at which representatives from FERC were still encouraging long-term contracts.

Mr. Vallow stated that this is a typical regulator's response, explaining that if there are all long-term contracts, there is nothing to regulate. He recalled that FERC had pushed until all the long-term contracts were signed and then capped the market. In answer to Ms. Hitchcock's earlier inquiry, he stated that FERC is one body he would not wait for to provide assistance.

Mr. Vallow clarified that the “risk” he referred to earlier was that the Utility found itself in a long position with surplus power at very inopportune times of the year. In addition, there was risk associated with the counter party (Calpine) that had been downgraded by rating agencies.

Sandra McDonald, of McDonald Partners, warned that other major energy market businesses with deteriorating credit risk have gone into bankruptcy. The Calpine contract term requires the City to make a payment even if the counter party is in bankruptcy. The terms of the contract say that the City needs to discount the contract at a U.S. Treasury rate.

Mr. Vallow added that instead of a 2.5% discount rate the proposed transaction is between 7.5% and 9.5% depending what power curve is used. Another objective was to shape the Utility's resource portfolio to more closely follow its load. The Utility has had robust large business and large industrial load growth, with fairly flat growth on the smaller business residential side. The proposal that Council had already approved was to

terminate the existing Calpine contract. For Council's consideration today is the issue of refinancing the cash flow stream to a stream that has a significant present value savings. He reported that in February 2001, 25 megawatts of base load power was purchased at \$65 a megawatt hour. The Utility's most expensive resource is its hydroelectric resource.

In answer to Council inquiries, Mr. Vallow recalled that on September 10, Lodi and Calpine amended the contract to provide termination of energy deliveries from Calpine to Lodi. In exchange for that the City has an obligation to pay \$525,000 a month commencing December 1. The City has an option to purchase the contract from Calpine for \$42 million. He stated that Calpine desperately needed the proposed transaction before closing its third quarter financials. An attempt was made to get other members of NCPA to participate. The City will use taxable and tax exempt bond proceeds to purchase the amended Calpine contract. Present value savings, as they were calculated yesterday at the assumed interest rate, is \$4.6 million.

In reply to Council Member Nakanishi, Mr. Vallow reported that the total cost of the Calpine contract was initially \$159 million. In reference to the Market Cost Adjustment (MCA), he stated that the proposed transaction will result in the City having \$4.6 million more to lower the MCA with over the same period of time.

Mr. Vallow explained that another risk driving this issue was that on September 30, Calpine had informed the Utility that it was intending to sell the contract to a bank. If that had happened, the City could not restructure the contract.

In response to Mayor Pro Tempore Hitchcock, Alex Burnett of Public Financial Management explained that the taxable portion is governed by tax law. There are restrictions on the ability to do this on a tax exempt basis in terms of matching the specific term of the existing Calpine contract. Mr. Burnett stated that all that could be done on a tax exempt basis is lower it and have it completely match the Calpine contract. A longer-term view was taken to sculpt the debt service to fit in based on the pro forma, which had to be done on a taxable basis. It is being extended three years, with 2015 being the final maturity date.

Mr. Vallow distributed a spreadsheet to Council (*filed and identified for the record as Exhibit A*) and referencing line 16, explained that it shows the proposed debt service replaced with the existing Calpine contract payments. He stated that in this scenario, in the year 2015, the Utility does not end up in a substantially different place, but it takes twelve years to get to that point. He asked Council to compare line 35 of this spreadsheet against the same line on the spreadsheet (*filed and identified for the record as Exhibit B*) distributed as part of the meeting handouts, which shows the ending balance difference between the "status quo" and the proposed transaction.

Council Member Land asked if NCPA is considering restructuring debt service.

Mr. Burnett replied in the affirmative and stated that refunding the 1993 bonds is currently being considered.

Mr. Vallow reported that three years ago the City sent NCPA \$7 million out of reserves to prepay an escrow account for geothermal. Bonds that year dropped to nearly zero and went up the next year. This created a "hole," which had it not been filled, would have resulted in cash balances going tremendously high in 2008. Mr. Vallow stated that payment was accelerated by filling the "hole" up.

Council Member Land asked if there would be an opportunity to pay it off sooner.

George Wolf, representative of Salomon Smith Barney, stated that his company will be the underwriter for this bond issue. He explained that call features of a bond issue are usually set the day of, or day before, they go to market. Based on the current market conditions and the outline of this proposed issue he believed it would be callable. Usual call protection is ten years forward, though they might explore having it callable on a year

earlier than that. The tax exempt fees will probably have an average interest rate of 4% and the taxable portion will likely be 4.5%.

Council Member Nakanishi asked Mr. Burnett whether he thought it would be better for the Utility to have 100% generation, or remain as it is with 80%.

Mr. Burnett stated that the market position the Utility is in now is favorable.

In answer to questions posed by Council, Mr. Burnett commented that the restructuring of this transaction makes a lot of sense. Only electric revenues are pledged, with no other City assets. He emphasized the importance of the City continuing to focus on the long-term stability of the Utility. The target is to go up to \$10 million in the next five years and the long-term reserve target remains at \$15 million. The current liquidity is \$2.5 million. It will be very important to look at the bulk power cost side and continue to monitor it as the Utility moves forward to ensure the projections are on target.

At the request of Mayor Pro Tempore Hitchcock, Mr. Burnett reviewed the spreadsheet (*Exhibit B*) and reported the following information:

- On the review side, rate revenue is the primary driver.
- Investment property revenues include interest income and fund balance both at the Utility level, as well as the NCPA General Operating Reserve (GOR) level. A footnote on the second page of the spreadsheet indicates that a 3% rate is assumed.
- Line 3 shows the assumptions on the MCA.
- Line 4, transfers from reserves, dovetails with line 32. A revenue and expense item in lines 1 through 10 calculates the net operating revenue. The debt service is subtracted and the impact on the fund balance is considered. If the fund balance is needed, it is pulled out as a negative in line 32.
- Lines 7 to 9 are the projected operating expenses. There is a significant drop off from 2002 and then to 2003 and projecting forward, which reflects the restructuring of the Calpine contract.

Mr. Vallow interjected that the capital program has approximately \$21 million for designated projects in the budget. Anything that is a capital program is being reimbursed, e.g. street lighting, line extensions, new feeder circuits and substations, etc.

Mayor Pennino asked that the Council be provided with a breakdown of operating and capital shown on line 7.

In answer to questions by Mayor Pro Tempore Hitchcock, Mr. Vallow reported that 2002 through 2005 include no capital expenses. Beginning in 2006 forward, the capital grows over a two-year period to its normal size of approximately \$2 million per year capital. The operating budget over time was tied directly to the load growth, which was about 1%. A 1.5% overall cost increase is expected with normal inflation.

Mr. Burnett continued:

- Line 9, bulk power, represents the new projected power costs with Calpine taken out. It also reflects the current forward market curves for any purchases that would need to be made specific to the actual demand of the City.
- Line 11, net operating revenue, is line 6 revenues less line 10 expenses.
- Lines 12 to 17 calculate the direct debt service that is bond specific to the Utility.
- Line 15, 2002 Certificates of Participation, is the repayment of the taxable piece.
- Line 16 represents the aggregate C and D.
- Line 17 is total direct debt service.

- Line 18 reflects proceeds from the 1999 project fund. Over time the earnings decrease assuming that there will be some draw down on the proceeds. It will be fully depleted by 2006. The earnings were net out against debt service.
- Line 19 calculates the net debt service.
- Line 11 by 19, direct debt service coverage, is the net operating revenues divided by the net direct debt service.
- Line 21 is total indirect debt service.
- Line 23 is the calculated debt service coverage based on an overall debt service coverage basis.
- Lines 24 to 35 calculate the fund balance specifically at the Utility.
- Line 25 is net revenues less direct debt service.
- Line 26 is other revenues, which are footnoted. It includes some capitalized expenses and a reimbursement from the trustee in part for accrued interest earnings on the 1999 proceeds that were never transferred to offset debt service, which should have been done on an annual basis, as has been projected going forward.
- Line 27, bond proceeds, the \$6 million and \$8,250,000 are the taxable proceeds.
- Lines 28 and 29 are changes in receivable and payables, which helps to reconcile cash versus accrual.
- Line 32, debt service coverage transfer, is a transfer up to operating expenses if needed.
- Line 33, transfers in, is for Electric Utility dispatching Public Works water and sewer system and White Slough electrical issues.
- Line 34 is the payment in-lieu.
- Line 35, the projected ending balance in 2003 is \$4.9 million. It is hoped to be over \$10 million by 2007, and \$15 million is targeted for 2011.
- Line 36, NCPA GOR balance, is the general operating reserve balance held at the NCPA level, and it is assumed that it will stay constant at \$2.9 million.

MOTION / VOTE:

The City Council, on motion of Council Member Land, Howard second, unanimously adopted Resolution No. 2002-212 authorizing the approval of certain documents related to the financing of the amended power sales agreement between Calpine Corporation and the City of Lodi.

C. MEETING OF THE LODI PUBLIC IMPROVEMENT CORPORATION

At 8:30 a.m., Mayor Pennino adjourned the Special City Council meeting to a meeting of the Lodi Public Improvement Corporation. Following call to order by President Pennino, Secretary Blackston recorded roll.

- C. "Adopt resolution authorizing the approval of certain documents related to the financing of the amended power sales agreement between Calpine Corporation and the City of Lodi"

MOTION / VOTE:

The Corporation, on motion of Director Land, Howard second, unanimously adopted Resolution No. LPIC2002-02 authorizing the approval of certain documents related to the financing of the amended power sales agreement between Calpine Corporation and the City of Lodi.

There being no further business to come before the Corporation, President Pennino adjourned the meeting of the Lodi Public Improvement Corporation at 8:31 a.m., and Mayor Pennino reconvened the City Council meeting.

*Continued October 22, 2002*

D. COMMENTS BY THE PUBLIC ON NON-AGENDA ITEMS

None.

E. ADJOURNMENT

There being no further business to come before the City Council, the meeting was adjourned at 8:31 a.m.

ATTEST:

Susan J. Blackston, City Clerk